

Message Text

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ACTION SS-25

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S E C R E T LISBON 7486

EXDIS

DEPT FOR ROBINSON, HARTMAN, GREENWALD AND PREEG

E.O. 11652: XGDS-1

TAGS: EFIN, EAID, PO

SUBJECT: PORTUGAL FACES SEVERE INTERNATIONAL LIQUIDITY
CRISIS

SUMMARY: PORTUGAL IS RAPIDLY APPROACHING SEVERE INTERNATIONAL
LIQUIDITY CRISIS THAT THREATENS RECENT INTERNAL POLITICAL GAINS.
THIS CABLE RECOMMENDS SEVERAL POSITIVE ECONOMIC MEASURES WE
CAN TAKE TO ASSIST IN MEETING THIS CRISIS. END SUMMARY.

1. FOLLOWING MESSAGE SUMMARIZES MY CONVERSATION WITH GREENWALD
AND PREEG AT CHIEFS OF MISSION CONFERENCE. GREATLY APPRECIATE
YOUR WILLINGNESS TO BE OF ASSISTANCE.

2. PORTUGAL IS RAPIDLY APPROACHING A SEVERE INTERNATIONAL
LIQUIDITY CRISIS DUE TO EXHAUSTION OF ITS FOREIGN EXCHANGE RE-
SERVES. PREVIOUS VASCO GONCALVES GOVERNMENTS DELIBERATELY RE-
FUSED TO ADOPT REFORMS NECESSARY TO AVERT IMPENDING BALANCE OF
PAYMENTS SQUEEZE. CURRENT AZEVEDO GOVERNMENT HAS DRAFTED
AUSTERITY PROGRAM, BUT UNTIL NOVEMBER 25 ITS POLITICAL BASE
WAS TOO INSECURE TO IMPLEMENT IT. AS A RESULT, PORTUGAL HAS
BEEN DRAWING DOWN ITS RESERVES AT A RATE OF ALMOST \$100 MILLION

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A MONTH. BY EARLY JANUARY, LIQUID RESERVES WILL BE VIRTUALLY

EXHAUSTED.

3. PORTUGAL'S GOLD RESERVES, VALUED AT APPROXIMATELY FOUR BILLION DOLLARS (MARKET), ARE PROVING TOO ILLIQUID TO BE OF MUCH ASSISTANCE. GOP HAS ATTEMPTED BOTH TO SELL PART OF ITS GOLD AND TO BORROW AGAINST IT. THESE NEGOTIATIONS HAVE BEEN INCONCLUSIVE. BANKERS REPORTEDLY ARE EXTREMELY RELUCTANT TO DEAL WITH LARGE GOLD VOLUMES BECAUSE OF MARKET'S CURRENT INSTABILITY AND BEARISH TENDENCY. THEY HAVE, THEREFORE, DEMANDED TERMS WHICH GOP FINDS POLITICALLY IMPOSSIBLE. THOUGH THESE DISCUSSIONS MAY EVENTUALLY PRODUCE SOME PARTIAL RESULTS, THEY ARE VERY UNLIKELY TO GENERATE SUFFICIENT LIQUIDITY IN TIME TO GIVE GOP REQUIRED FLEXIBILITY.

4. LACK OF EXTERNAL RESOURCES WOULD HAVE SERIOUS INTERNAL RAMIFICATIONS, THREATENING RECENT POLITICAL GAINS. GOP WOULD BE FORCED TO ADOPT SEVERE RESTRICTIONS, ESPECIALLY ON ITS CURRENT ACCOUNT TRANSACTIONS. ECONOMY WOULD DECLINE RAPIDLY AS IMPORTS FALL, PRODUCTION DECREASES, INFLATION ACCELERATES AND UNEMPLOYMENT INCREASES. GENERAL POPULATION WOULD TEND TO REACT FORCEFULLY AS ITS REAL INCOME FALLS PRECIPITOUSLY BY SOME 15 TO 20 PERCENT IN 1976. PORTUGAL'S DELICATE POLITICAL FABRIC WOULD BE STRAINED BY RESULTING SOCIAL STRIFE. RECENT POLITICAL GAINS WOULD PROBABLY BE REVERSED AND SUBSEQUENT CHAOTIC POWER STRUGGLE WOULD OPEN WAY FOR COMMUNIST RESURGENCE.

5. AZEVEDO GOVERNMENT HAS BEEN DISAPPOINTED BY WESTERN WORLD'S RELUCTANCE TO PROVIDE MASSIVE ECONOMIC ASSISTANCE. ITS MEMBERS HAD, FROM THEIR DISCUSSIONS WITH U.S. AND EUROPEAN OFFICIALS AS WELL AS FROM THEIR ANTI-COMMUNIST SELF-IMAGE, COME TO EXPECT A RAPID, LARGE AID INFLOW OF PERHAPS ONE BILLION DOLLARS. THOUGH GOP REALIZES ITS OWN FAILURE TO PREPARE ADEQUATELY FOR SUCH ASSISTANCE, IT BELIEVES WESTERN WORLD HAS NOT LIVED UP TO ITS PROMISES.

6. GOP OFFICIALS HAVE TENDED TO PROCRASTINATE BUT NOW REALIZE THAT THEY MUST ACT OR MARKET FORCES WILL TAKE DECISIONS OUT OF THEIR HANDS. IN LATTER CASE, ECONOMIC IMPACT AND POLITICAL REACTION WOULD BE EVEN WORSE. THEY HAVE THEREFORE DECIDED TO MOVE AHEAD ON ITS AUSTERITY PROGRAM DESPITE POLITICAL DANGERS.

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FIRST MAJOR PORTIONS OF THE PROGRAM ARE EXPECTED TO BE APPROVED BY COUNCIL OF MINISTERS ON DECEMBER 19.

7. ACTION REQUESTED: URGENTLY REQUEST THAT USG TAKE FOLLOWING STEPS TO HELP EASE PORTUGAL'S LIQUIDITY CRISIS:

A. ARRANGE ONE YEAR DOLLAR/ESCUDO "SWAP" OF APPROXIMATELY \$200 MILLION;

B. SUBSTANTIALLY INCREASE 1976 PL 480 FROM CURRENTLY
AUTHORIZED LEVEL OF \$15 MILLION;

C. ACTIVELY SUPPORT GOP'S EFFORTS TO BORROW FROM
INTERNATIONAL INSTITUTIONS, PARTICULARLY IMF;

D. PRESS WESTERN EUROPEAN NATIONS TO ASSIST PORTUGAL BY
SUPPORTING ITS EFFORTS IN IMF, PROVIDING EMERGENCY BILATERAL
LOANS, ENCOURAGING EUROPEAN INSTITUTIONS SUCH AS BIS TO INCREASE
THEIR CREDITS, AND BY ACCELERATING NEGOTIATIONS FOR TRADE CON-
CESSIONS TO PORTUGAL;

E. RENEW EXPORT-IMPORT BANK LONG-TERM CREDITS FOR
ECONOMICALLY VIABLE PROJECTS APPROVED BY PORTUGUESE GOVERNMENT;

F. ONCE ABOVE DECISIONS HAVE BEEN TAKEN, ENCOURAGE PRIVATE
BANKING SYSTEM TO AUGMENT CREDITS TO PORTUGUESE INSTITUTIONS.
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